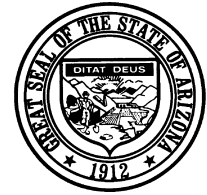


ARIZONA TAX NEWS



Jane Dee Hull, Governor

Mark W Killian, Director

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E-Mail Your Questions

If you have a question that you cannot find the answer to, our Technical Assistance personnel may prove useful to you. We will gladly respond to any e-mail technical tax inquiry with the exception of specific account inquiries. All inquiries will be responded to within two working days.

E-mail your question to:
TaxpayerAssistance@revenue.state.az.us

In the interest of maintaining confidentiality, DOR cannot respond to inquiries that include a Social Security number, FEIN, TPT or W/H number, or other specific taxpayer identifiers.

Federal Retiree Program & Federal Employees Retirement Contribution Program

During the month of February 2001 no refunds were issued to taxpayers as a result of the FRP or FERC programs. However, The law firm of Bonn, Lusher, Padden & Wilkins won a recent decision entitling the firm to 20% of each FERC claimant's refund that benefited from their work. In

December 1997, the firm obtained a temporary restraining order requiring the department to withhold 20% of those refunds. During the month of February 2001 a warrant in the amount of \$2.955 million was issued to the law firm of Bonn, Lusher, Padden & Wilkins as a result of the court decision.

DOR Reorganization Begins July 1, 2001

In order to position itself for BRITS (Business Reengineering Integrated Tax Systems), the Department of Revenue is reorganizing itself to increase efficiency of operations, promote sound business practices, and to improve service to taxpayers and practitioners. Effective July 1, 2001 Divisions (Taxation, Data Management, etc.) are replaced with Functions. Functions are managed by a function executive or a team with a designated team leader. Assistant Director positions will be eliminated and are replaced with function executives. Functions are regrouped so that all the direct tax administration activities (processing, taxpayer service, audit etc.) for all tax types are located in one program area

called Tax Administration. Planning, budget, change management, hearing office and all other support services are located in another program area called Planning and Support. Strategic issues are handled by the Leadership Team which is comprised of executives or team leaders from each of the main functions as well as the two Deputy Directors. These strategic issues include resource allocation (staffing and equipment), budget development and allocation, and operational policies that were formerly done in the Divisions. The Leadership Team also acts as a sponsor for major cross-discipline projects. The reorganization in agency leadership has led to the reorganization of functions under

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*****REMINDER*****

FOR NON-EFT TPT FILERS

To avoid a delinquency, postmark your
June 2001 TPT return no later than
**July 25, 2001 or deliver to DOR no later than
July 30, 2001.**

February Summary of General Fund Revenues

	February 2001	Fiscal Year Total
Individual Income Tax		
Net Collections	\$27,754,343	\$1,376,455,035
Percent Change *	(67.3%)	2.7%
Corporate Income Tax		
Net Collections	\$5,619,236	\$323,855,672
Percent Change *	279.4%	22.3%
Transaction Privilege, Severance & Use Taxes		
Net Collections	\$238,620,118	\$1,984,833,675
Percent Change *	10.2%	7.3%
Total Big Three Tax Types		
Net Collections	\$271,993,697	\$3,685,144,382
Percent Change *	(10.2%)	6.6%

() Decrease from same month last year.

* Percent change from same month last year.

Individual Income Tax

Individual Income Tax Receipts

	February 01	February 00	%Change
Gross Collections	\$7,162,868	\$9,175,796	(21.9)
Withholding	197,821,024	213,303,374	(7.3)
Refunds*	(114,191,828)	(106,235,564)	35.7
Urban Rev Sharing	(33,037,720)	(31,475,916)	5.0%
Net Collections	\$27,754,343	\$84,767,690	(67.3)%
Fiscal Year Total (00/01) (99/00) % Change			
Gross Collections	\$303,106,283	\$297,080,859	2.0%
Withholding	1,579,197,060	1,494,745,719	5.6
Refunds*	(241,546,547)	(199,291,509)	(21.2)
Urban Rev Sharing	(264,301,760)	(251,807,326)	5.0
Net Collections	\$1,376,455,035	\$1,340,727,743	2.7

*See page one: Federal Retiree Program & Federal Employees Retirement Contribution Program

Just a Reminder

The Education Transaction Privilege Tax approved with Proposition 301 is effective beginning June 1, 2001. The 0.6% additional state rate will apply to all TPT classes listed in 42-5010 (A) (1) and Use Tax.

TAX CALENDAR

JULY 2001

Due Date		For Period Ending
4	State Holiday-4th of July	All State Offices Closed
16	Income Tax Returns: Form 120: Corporation Form 140: Individual Form 141: Fiduciary Form 165: Partnership	3/31/01
16	Form 120: Corporation with Automatic Extension	9/30/00
16	Form 120S: S Corporation	4/30/01
16	Form 99: Exempt Organization Annual Information Return Form 99T: Exempt Organization	2/28/01
16	Form 120ES: Estimated Tax Payment, Corporation First Installment Second Installment Third Installment Fourth Installment	3/31/02 1/31/02 10/31/01 7/31/01
20	Form TPT-1: Transaction Privilege Tax: June Monthly Filers and Quarterly Filers	6/30/01
20	Bingo: Financial Reports	6/30/01
20	Luxury Tax: Various Forms	6/30/01
25	EFT Form TPT-1 and Payment: Transaction Privilege Tax: June Monthly Filers	6/30/01
31	Form A1-QRT Withholding Tax	6/30/01

Withholding Information:

If the average amount of Arizona income taxes withheld in the preceding four calendar quarters **exceeds** \$1,500 the employer must make its Arizona withholding payments to the Department of Revenue at the same time as the employer is required to make federal withholding deposits.

If the average amount of Arizona income taxes withheld in the preceding four calendar quarters **does not exceed** \$1,500 the employer must make its Arizona withholding payments to the department on a quarterly basis.

The Arizona Tax News is a monthly publication of the Arizona Department of Revenue. Information contained herein is of a general nature and is not designed to address complex issues in detail. Taxpayers requiring information concerning a specific tax matter should contact the appropriate office. This newsletter is available in alternative formats upon request by calling the telephone number shown below. Subscription information may be obtained from Tony Manzo at (602) 542-3062 or toll free 1 (877) 863-0655.

Arizona Corporate Tax Ruling CTR 01-1

ISSUE:

Does a federal tax-free Internal Revenue Code § 351 reorganization affect the Arizona unitary determination of the affiliated companies?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-941 provides for filing of a combined return of two or more affiliated corporations when necessary to properly reflect Arizona income.

Arizona Administrative Code (A.A.C.) R15-2D-401 provides guidance on the determination of a unitary business.

Internal Revenue Code (I.R.C.) § 351 provides for a tax-free transfer of property to a controlled corporation solely in exchange for stock in that corporation.

Container Corp. of America v. Franchise Bd. of California, 463 U.S. 159 (1983), established constitutional standards for combined filing of a unitary business.

Talley Industries, Inc. v. Arizona Department of Revenue, 182 Ariz. 17, 893 P.2d 17 (App. 1994), established the standards for combined filing of a unitary business in Arizona.

DISCUSSION:

An I.R.C. § 351 reorganization provides for a tax free transfer of property to a controlled corporation solely in exchange for stock in that corporation. Although this results in a change in the *form* of the business, it generally does not affect the substance of the business operations.

A.R.S. § 43-941 provides for the filing of a combined return in the case of a unitary business conducted by two or more corporations. A.A.C. R15-2D-401 and a number of cases, including *Talley Industries, Inc. v. Arizona Department of Revenue*, 182 Ariz. 17, 893 P.2d 17 (App. 1994), provide that the determination of the proper reporting of a unitary business is based on the operation of the business activities and not on the form of the business.

After an I.R.C. § 351 reorganization, the new corporation controlling the assets generally remains an affiliated corporation and the activities of the group generally remain unchanged. Activities conducted as part of a unitary business do not become a separate and unrelated business simply because those activities are subsequently conducted by a different affiliated corporate entity.

RULING:

An affiliated corporation resulting from an I.R.C. § 351 reorganization is required to file a combined return as part of the unitary group if its activities are conducted as a part of the unitary business.

Mark W. Killian, Director

Signed: May 2, 2001

Arizona Corporate Tax Ruling CTR 01-2

ISSUE:

How does a taxpayer filing an Arizona corporate income tax return determine whether computer software is included in the property factor?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-102(A)

(3) adopts the provisions of the Internal Revenue Code relating to the definitions of income, deductions, and accounting methods.

A.R.S. § 43-1140 provides that the property factor shall include real and

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tangible personal property used in the taxpayer's business.

Arizona Administrative Code (A.A.C.) rule R15-2D-604 provides that for purposes of the property factor, the value of the property shall be its basis for federal income tax purposes.

Internal Revenue Code (I.R.C.) § 167(f)(1) provides for the depreciation of computer software using the straight line method over a thirty-six month period.

I.R.C. § 197(e) provides for the amortization of intangibles and includes certain software but not canned software.

DISCUSSION:

A.R.S. § 43-1140 provides that the property factor shall include real and tangible personal property used in the taxpayer's business. The property factor does not include intangible property or items that have been expensed. Arizona conforms to the Internal Revenue

Code in the determination of the value and nature of business assets. Therefore, computer software that has been treated as tangible personal property and capitalized for federal tax purposes will be treated similarly for Arizona tax purposes. A.R.S. § 43-1140 provides that the numerator of the property factor shall include real and tangible personal property used in this state. Computer software is includible in the numerators of the states in which the software is actually used, not in the state where the original program disk or tape is located.

RULING:

Under ordinary circumstances, the property factor includes only software treated as tangible personal property on the federal income tax return. The value of the software shall be attributed to the numerators of the states in which the software is used on a reasonable basis.

Mark W. Killian, Director

Signed: May 1, 2001

Arizona Transaction Privilege Tax Ruling TPR 01-1

ISSUE:

Taxation of activities performed by lawn, garden or tree maintenance businesses.

APPLICABLE STATUTES AND RULES:

Arizona Revised Statutes (A.R.S.) § 42-5075 *Prime contracting classification*, imposes the transaction privilege tax on 65% of the gross proceeds of sales or gross income derived from the business of prime contracting. A "contractor" means any person or other entity that constructs, alters, repairs, adds to, subtracts from, improves, moves, wrecks or demolishes any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement, or does any part of such a project, including the erection of scaffolding or other structure or works in connection

with such a project, and includes subcontractors and specialty contractors.

Arizona Administrative Code (A.A.C.) R15-5-614 distinguishes between taxable prime contracting activities, taxable retail sales, and nontaxable service activities. This rule includes lawn mowing and garden maintenance as nontaxable service activities.

A.R.S. § 42-5061 *Retail classification*, is comprised of the business of selling tangible personal property at retail. The transaction privilege tax is imposed on the gross proceeds of sales or gross income derived the business. A.R.S. § 42-5061(A)(1) provides an exclusion from tax for "[p]rofessional or personal service occupations or businesses which involve sales or

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transfers of tangible personal property only as inconsequential elements.” A.R.S. § 42-5061(A)(2) provides an exclusion from the tax for services rendered in addition to selling tangible personal property at retail.

A.A.C. R15-5-104 *Service Businesses* states:

A. Gross receipts from the sales of tangible personal property to a person engaged in a professional or personal service occupation or business are taxable if the tangible personal property is used or consumed in the performance of the service or is sold only as an inconsequential element of the nontaxable service provided.

B. Gross receipts from the sale of tangible personal property, by a person engaged in a professional or personal service occupation or business, shall not be taxable if the property is sold only as an inconsequential element of the nontaxable service provided.

C. Sales of tangible personal property shall be considered inconsequential elements of the service if:

1. The purchase price of the tangible personal property to the person rendering the services represents less than 15% of the charge, billing, or statement rendered to the purchaser in connection with the transaction;
2. At the time of the sale, the tangible personal property transferred is not in a form which is subject to retail sale; and
3. The charge for the tangible personal property is not separately stated on the invoice.

D. A person engaged in both a retail

business and a service business shall keep records of purchases of tangible personal property sufficient to establish whether the property was resold as a taxable retail sale.

A.A.C. R15-5-105 *Services in Connection with Retail Sales*, states that a charge for a service in connection with a retail sale is taxable unless the charge for service is shown separately on the sales invoice and in the business’ records.

A.A.C. R15-5-133 *Delivery Charges in Connection with Retail Sales*, subsection (A), states that a charge by a retailer for delivery from the retailer's location to the purchaser's location, if separately stated on the sales invoice, is not taxable.

DISCUSSION:

Lawn, garden or tree maintenance businesses (hereafter: lawn maintenance businesses) are those that provide the services of lawn mowing and edging, tree and bush trimming/pruning, weeding, leaf raking and removal, and other activities that maintain the general upkeep of outdoor areas. These types of maintenance activities that do not involve alterations to the real property, are considered nontaxable services.

Some lawn maintenance businesses also provide other services such as fertilizing, spraying insecticides or herbicides, or other service activities that involve the transfer of tangible personal property. As long as the tangible personal property is either used or consumed in the performance of the service or is sold only as an inconsequential element of the nontaxable service as addressed by A.A.C. R15-5-104, the sale is nontaxable. The purchase of

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tangible personal property that will be used or consumed in a nontaxable service activity or transferred to the customer as an inconsequential element of the service, is subject to tax at the time of purchase. Lawn maintenance businesses that engage in nontaxable services that involve the transfer of tangible personal property to the customer, must keep books and records that separately show the purchases of tangible personal property.

Often, lawn maintenance companies may supply sprinkler heads and other small watering system parts that are broken off during mowing or other lawn maintenance activities. As long as there are no separate charges to the customer for these items, these are considered to be consumed by the lawn maintenance business in providing its services. As such, the sprinkler heads and other small watering system parts are subject to tax when purchased by the lawn maintenance business.

Taxable Prime Contracting Activities

Some lawn maintenance businesses perform other work for their customers that are not nontaxable services, but are instead taxable prime contracting activities. Prime contracting activities include the installation of trees or other plants (regardless of size); the removal of trees or other embedded plants; the installation or repair of sprinkler/watering systems; the building or modification of irrigation berms; and other actions that alter real property. The entire charge for these prime contracting activities including any material or labor costs, comprise the gross proceeds of sales or gross income that is multiplied by 65% to arrive at the tax base for the prime contracting classification.

Taxable Retail Sales (including “non-inconsequential” transfers of tangible personal property)

A lawn maintenance business’ separate sales of

tangible personal property to its customers unrelated to prime contracting activities are taxable under the retail classification. There may be service charges related to these sales of tangible personal property, which must be separately stated in order to be considered nontaxable.

A lawn maintenance business that transfers tangible personal property to the customer in conjunction with a service, should carefully review whether the transfer of tangible personal property qualifies as an “inconsequential element” of a service under A.A.C. R15-5-104 (C). Tangible personal property that is transferred to the customer in conjunction with a service activity does not qualify as an inconsequential element of the service if the purchase price of the tangible personal property *exceeds* 15% of the total charge; if the tangible personal property *is* in a form subject to retail sale; or if the tangible personal property *is* separately invoiced. If any of these three criteria are present, the charge for the tangible personal property must be invoiced as a retail sale and is taxable. If the billing does not separately state the charge for the tangible personal property and separately state the charge for the service activity, the entire amount will be taxable as a retail sale.

For example, a lawn maintenance business provides the service of putting in a winter lawn for a customer, by reseeding the lawn with a special type of grass seed. If the purchase price of the grass seed exceeds 15% of the business’ total charge for reseeding the lawn, the tangible personal property transferred to the customer does not qualify as an inconsequential element of a service. Therefore, the lawn maintenance business must separately charge for the grass seed. The charge for the service of reseeding must be a separate charge in order for this charge to be considered nontaxable.

Transaction Privilege Tax License

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A lawn maintenance business that engages in prime contracting activities and/or makes retail sales of tangible personal property, must obtain a transaction privilege tax license from the Arizona Department of Revenue and report and pay the applicable taxes due to the state on taxable income. An *Arizona Joint Tax Application* is used to apply for a transaction privilege tax license and may be obtained at any of the department's offices, or online at the department's website. (See the Appendix attached to the end of this ruling for more information.)

Exempt Retail Purchases by a Taxable Lawn Maintenance Business

A lawn maintenance business that engages in prime contracting activities or retail sales, may make exempt purchases of certain items of tangible personal property by providing a valid exemption certificate to the seller. A.R. S. § 42-5061(A)(27) provides an exemption for tangible personal property that will be incorporated into a prime contracting project. Therefore, a licensed contractor engaged in a lawn maintenance or landscaping business may purchase plants or trees that will be installed onto a customer's property exempt from tax. A.R. S. § 42-5061(V)(3) provides an exclusion for sales of tangible personal property that will be resold in the regular course of business. Therefore, a lawn maintenance business that will make a retail sale of grass seed or other tangible personal property to a customer, may purchase the tangible personal property as a nontaxable sale for resale. Arizona Transaction Privilege Tax Procedure *TPP 00-3, Procedure for Use of Exemption Certificates*, explains the proper use and acceptance of certificates that exempt the purchaser from tax.

RULING:

Lawn, garden and tree maintenance businesses provide the nontaxable services of lawn mowing and edging, tree and bush trimming or pruning,

weeding, leaf raking and removal, and other activities that maintain the general upkeep of outdoor areas. These types of maintenance activities that do not make alterations to the real property, are considered nontaxable services. Some lawn maintenance businesses also provide other services such as fertilizing, spraying insecticides or herbicides, or other service activities that involve the transfer of tangible personal property. As long as the tangible personal property is either used or consumed in the performance of the service or is sold only as an inconsequential element of the service (as addressed by A.A.C. R15-5-104), the sale of the service including the transfer of tangible personal property is nontaxable.

However, some lawn maintenance businesses also engage in taxable prime contracting activities or make taxable retail sales. Business records and customer invoices should separate income derived from nontaxable services from the income derived from taxable prime contracting activities and retail sales. A lawn, garden or tree maintenance business that engages in prime contracting activities and/or makes retail sales of tangible personal property, must obtain a transaction privilege tax license from the Arizona Department of Revenue and report and pay the applicable taxes to the state on taxable income.

For a lawn maintenance business or a retail business, the following are examples of nontaxable service activities, taxable retail sales, and taxable prime contracting activities. This listing is not all inclusive.

Nontaxable service activities:

Lawn mowing and edging
Weeding
Lawn de-thatching
Leaf/debris collection and removal
Tree/bush pruning or clipping

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Garden/gravel raking
Insecticide/herbicide/fertilizer spraying

Taxable retail sales:

Separate charges for:

Fertilizer/lawn seed*
Sprinkler heads or drip irrigation heads
Sales of plants that are not installed or
embedded in real property

* When the fertilizer or seed does not
qualify as an inconsequential element of
a service activity per A.A.C. R15-5-104.

Taxable prime contracting activities:

Installation of lawns
Grading or leveling
Installation of gravel or boulders
Planting of trees or other plants
Cutting down trees; removal or mulching of tree
stumps; removal of other embedded plants
Building or modifying irrigation berms
Installing railroad ties
Repairing or installing underground sprinkler or
watering systems

Mark W. Killian, Director

Signed: May 15, 2001

Appendix to Arizona Transaction Privilege Tax Ruling TPR 01-1

Arizona Joint Tax Application

An *Arizona Joint Tax Application* is used to
apply for a state transaction privilege tax
license, as well as many of the other licenses
that are needed to conduct business in
Arizona. This application is available at any
A.D.O.R. office, as well as on the
department's website, **www.revenue.state.
az.us**. The Arizona Joint Tax Application
may also be obtained by calling the
department's Tax Forms Section at (602)
542-4260.

**The following are also available from the
department or on the department's
website:**

**Arizona State, County and City
Transaction Privilege and other Tax Rate
Tables** provide breakdowns of combined
state transaction privilege tax and county
excise tax rates, and also city privilege and
use tax rates for those cities whose taxes are
collected by the state. These tables also
provide a list (and the phone numbers) of

those cities that license and collect their own
taxes.

The **A.D.O.R. Transaction Privilege Tax
Exemption Certificate** (Arizona Form 5000)
may be used to make exempt purchases of
tangible personal property by a prime contractor,
or exempt purchases of tangible personal
property for resale in the ordinary course of
business. Arizona Transaction Privilege Tax
Procedure **TPP 00-3, Procedure for Use of
Exemption Certificates**, explains the proper use
and acceptance of certificates that exempt the
purchaser from tax.

Department Publications:

A.D.O.R. Pub 609, Guide to Arizona
Licensing Requirements

A.D.O.R. Pub 611, A Guide to Taxes for
Arizona Businesses

A.D.O.R. Pub 603, Contracting
Activities

A.D.O.R. Pub 602, Retail Sales
A.D..R. Pub 619, Excise Tax

Eloy Change in City Tax Code Effective July 1,2001

The Mayor and City Council of the City of Eloy passed ordinance 01-510. Ordinance 01-510 increases the Eloy City Transaction Privilege Tax from 2% to 3%. The tax rate increase affects the following classifications:

- ◆ Advertising
- ◆ Amusements
- ◆ Construction contracting
- ◆ Job printing
- ◆ Manufactured buildings
- ◆ Timbering & other extraction
- ◆ Publishing
- ◆ Rental of real property
- ◆ Retail sales
- ◆ Telecommunications
- ◆ Transporting for hire

◆ Utilities

The privilege tax rate for **Additional Tax on Transient Lodging** is increased from 2% to 4%, reported using **CODE EL3**. This is in addition to the 3% Privilege Tax Rate on Hotels, reported using **CODE EL**, for a total rate of 7%.

The privilege tax rate for Restaurants and Bars is increased from 4% to 6%, reported using **CODE EL9**.

This increase imposed by this ordinance shall not apply to contracts entered into prior to the effective date of the ordinance. **Pre-existing contracts** should be reported using **CODE EL4** at a rate of 2%.

Changes To The Arizona State, County and City Transaction Privilege and Other Tax Rate Tables.

Effective May 1st, 2001

City/Town Name	Region Code	Tax Rate	County
Cottonwood (F)			YAV
Privilege Tax	CW	2.2 %	
Utilities	CW1	1 %	
Hotel/Motel (Additional Tax)	CW3	2 %	

Effective July 1st, 2001

City/Town Name	Region Code	Tax Rate	County
Eloy (F)			PNL
Privilege Tax	EL	3 %	
Hotel/Motel (Additional Tax)	EL3	4 %	
Contracts Pre 7/01	EL4	2 %	
Restaurant/Bar	EL9	6 %	

Effective July 1st, 2001

City/Town Name	Region Code	Tax Rate	County
Surprise			MAR
Privilege Tax	SP	2 %	
Hotel/Motel (Additional Tax)	SP1	3 %	
Food Tax	SP2	1 %	
Restaurant/Bar	SP3	5 %	
Retail Tax portion single item over \$5,000	SP4	1 %	

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them. Many programs have moved to a team based structure that will improve internal communication and efficiency. This will, in turn, improve service to internal and external customers and

stakeholders.

Although the Department is changing some of it's internal relationships, contacts from outside the agency remain the same. Practitioner hot-lines remain unchanged as do fax numbers.

Employer Potpourri 2001

Whether you are a tax professional, new employer, or have had employees for years, you will leave with a better understanding of the responsibilities of an employer in Arizona. You may be eligible for Continuing Professional Education Credit (CPE). Information goes beyond the basics - sessions are geared to offer attendees more opportunities to ask questions. This provides a rare opportunity to get comprehensive information from several agencies all in one location for a reasonable price!

These agencies will be represented:

US Department of Labor, Wage and Hour Division
Social Security Administration
Immigration and Naturalization Service
Internal Revenue Service
Arizona Department of Economic Security, Child Support Enforcement
Arizona Department of Economic Security, FUTA - SUTA
Arizona Department of Revenue

Where:

Phoenix - June 19, Country Suites, 3210 NW Grand Ave
Tempe - June 20, Sheraton Phoenix Airport, 1600 S 52nd St
Tucson - June 13, Holiday Inn Palo Verde, 4550 S Palo Verde

Seminars begin at 8 am with a no-host lunch and conclude at 5 P.M..

Nonrefundable cost of the program is \$69 per person. Registration information may be obtained from the Community Outreach & Education Section at (602) 542-3062 or toll free 1 (877) 863-0655.